

9 June 2023



Taxation of environmental land management and ecosystem service markets

Response from ICAS

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About ICAS

The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 23,600 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members in the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

ICAS was created by Royal Charter in 1854. The ICAS Charter requires its Boards to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Our response

1. The following submission has been prepared by the ICAS Tax Board. The Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community; it does this with the active input and support of over 60 committee members.

Background comments

2. ICAS is grateful for the opportunity to contribute its views on this HM Treasury [consultation](#), entitled "Taxation of environmental land management and ecosystem service markets".

General comments

3. ICAS recognises the importance of initiatives which help the UK work towards achieving net zero. We fully support any proposal to extend Agricultural Property Relief for Inheritance Tax so that land being used for environmental land management and ecosystem service markets would still qualify, as we feel that it is important that there is not a tax disincentive for businesses to participate in such initiatives.
4. We do however feel that there is merit in exploring extending this to Business Property Relief for Inheritance Tax, as where a landowner is farming the land themselves there could be an Inheritance Tax disadvantage if there is a value of land in excess of agricultural value.
5. ICAS believes that taxpayers and agents need clearer HMRC guidance to ensure that they are aware of the correct treatment of income generated by ecosystem service markets. This is a subject on which we have received feedback from several of our members, who are seeking clarity in order that they can ensure that transactions can be correctly treated in their clients' tax returns.
6. We note the various English environmental land management initiatives mentioned in the consultation. As a professional body with members based throughout the UK, we feel that it is important that any similar schemes that operate in Scotland, Wales or Northern Ireland are given equivalent treatment for UK wide taxes. The importance of effective environmental land management applies equally throughout the UK.
7. In any proposal to change the Inheritance Tax reliefs, it is important to bear in mind that the differences between the Scottish legal position on leases and that of other parts of the UK. Taxpayers should be treated fairly and consistently, regardless where in the UK they reside and where the land that they own and/or farm is located.

Part 1: Call for evidence on the taxation of ecosystem service markets

Q1: What has been, or would be, the effect of ecosystem service payments on existing business models, such as farming or commercial timber production?

8. Our members who act for agricultural businesses regularly tell us the importance of the existing Basic Payment Scheme in terms of the current profitability and viability of farming businesses. As the Basic Payment Scheme becomes less relevant in future years, ecosystem service payments will play an increased role in the longer term.
9. The likely impact on farming businesses will depend on the particular ecosystem service payment scheme in place. Many of these will result in a change of land use to facilitate ecosystem service delivery. In some cases, it will be possible to carry out some farming activity, although this will very much vary between farming businesses.
10. ICAS believes that it is important that there is not a tax disadvantage for farming businesses being involved in such activities. Inheritance Tax is specifically addressed in later sections, however the farming specific aspects of the Income Tax and Corporation Tax legislation should also be borne in mind so that there is no disadvantage in those respects.
11. At present, income from a Basic Payment Scheme entitlement received by a farming business is chargeable as trading income for Income Tax and Corporation Tax purposes. For unincorporated businesses, the definition of farming profits affects the profit/loss under the farmers' averaging scheme. In all cases, it affects the loss restrictions under Section 67 ITA 2007 (unincorporated businesses) and Section 48 CTA 2010 (companies) for farming businesses which incur losses before capital allowances for more than five consecutive tax years. Given that farming businesses will rely more on ecosystems service payments in future, we feel that it is important that income receipts from such schemes can still be treated as trading income of the farming business in future.

Q2: What are the main areas of uncertainty in the taxation of trading income for income tax and corporation tax in relation to the production and sale of units generated by ecosystem service markets? Please provide evidence and scenarios, including the relative scale of the concern by explaining where decisions have and have not been influenced by the uncertainty of the tax treatment.

12. ICAS believes there is an urgent need for clarification on the tax treatment on the sale of carbon units and ecosystem service units. Businesses need to be clear about whether this should be taxable as income or as a capital gain. The absence of clear guidance may deter some farming businesses from entering the market.
13. Woodland carbon units are specifically mentioned in the consultation. ICAS believes that the tax position needs to be made clear as to whether these would be included within the existing tax exemptions for income from commercial woodland. Section 768 ITTOIA 2005 (unincorporated businesses) and Section 980 CTA 2009 (companies) provides exemption for income from commercial woodland being managed on a commercial basis with a view to realising profits. The legislation is silent on a requirement for the sale of timber, so it does not seem entirely unreasonable to argue that woodland carbon units could potentially fall within the scope of the exemption.
14. In contrast, by definition, the scope of peatland carbon credits clearly does not fall within the exemptions for commercial woodland.

Q3: Should the tax system account for the timing difference between the upfront and ongoing project costs, with the delay in receiving income generating units – for example, should the tax system provide tax certainty in respect of timing mismatches, which may require an override to the accounting treatment?

15. Aside from our other comments, we believe that the accounting treatment should largely determine the timing of the tax treatment.
16. Farming businesses need to be clear about any upfront payments should be taxed as income or capital. We feel that there could be some merit in a system similar to the model used for lease premiums being adopted, in that part of the upfront payment would be taxable as capital and the rest taxable as income. This approach would reflect the fact that the benefit of the upfront payment would be realised over the lifetime of the arrangement.

Q4: How could greater clarity be provided in these areas (e.g. guidance, law changes)?

17. Improved HMRC guidance on whether income received the sale of carbon units and ecosystem service units should be treated as trading income for Income Tax and Corporation Tax purposes, or alternatively taxed as a capital gain.
18. As above, consideration should be given to the merits of a system similar to lease premiums for the taxation of upfront payments.
19. The definition of commercial woodland needs to be more explicitly outlined so that businesses are clear about whether this includes income from woodland carbon credits. The legislation is silent on the need for there to be a sale of timber, which leaves the existing guidance open to interpretation.
20. ICAS believes that the tax legislation should enable the Treasury to have the power to extend the scope of a particular tax treatment for new schemes that may operate throughout the UK. This would mean that the tax legislation could be more adaptable and agile to new initiatives that may be introduced, reducing confusion and lack of clarity over the tax treatment for future schemes.

Q5: Are there any other areas of uncertainty in respect of the broader taxation of the production and sale of units generated by ecosystem service markets? Please provide evidence and scenarios, including the relative scale of the concern by explaining where decisions have and have not been influenced by the uncertainty of the tax treatment.

21. We make no representations in respect of VAT as it is our understanding that this is outwith the scope of the consultation.
22. Assuming the proposed changes to extend Agricultural Property Relief for Inheritance Tax take effect, this will automatically impact on the availability of Capital Gains Tax Holdover Relief under Section 165 TCGA 1992, given the cross reference at Schedule 7 TCGA 1992.
23. ICAS does however feel that it would be appropriate to extend the scope of Rollover Relief under Section 152 TCGA 1992 so that there can be a mechanism to avoid a Capital Gains Tax liability arising where there is a sale of units when the proceeds are reinvested in another qualifying asset. Alternatively where the proceeds on the sale of a qualifying asset are reinvested into qualifying units. This could be achieved by amending Section 156 or Section 158 TCGA 1992, in order that it is clear the extent the reference to commercial woodland in Section 158 TCGA 1992 applies.
24. A similar extension to the scope of Business Asset Disposal Relief for Capital Gains Tax would be desirable.

Q6: How could greater clarity be provided in these areas (e.g. guidance, law changes)?

25. To achieve greater clarity, amendments to TCGA 1992 in respect of Rollover Relief and Business Asset Disposal Relief would be necessary to ensure that there was no disadvantage for land used for environmentally beneficial schemes.
26. As noted above, no amendments would be necessary to facilitate Holdover Relief provided the proposed changes to Agricultural Property Relief for Inheritance Tax take effect.

Part 2: Consultation on Agricultural Property Relief from Inheritance Tax and environmental land management

Q1: What are the areas of concern in respect of agricultural property relief and environmental land management? Please provide evidence and scenarios, including the relative scale of the concern by explaining where decisions about land use change have and have not been influenced by the scope of agricultural property relief.

27. ICAS believes that it is important to ensure that there is not a tax disincentive for businesses to participate in environmental land management schemes. We feel that a long-term approach is important in bringing environmentally beneficial schemes within the definition of agricultural purposes for Inheritance Tax. As such, we support the extension of Agricultural Property Relief to include cases where land is used for environmental land management.
28. Our members have reported concerns that in respect of where tenants want to take part in environmental schemes (or breach their leases by taking part). If the Agricultural Property Relief rules are not altered, the landowner would lose entitlement to relief, potentially for a situation outwith their control. This is not necessarily a new problem (as there could be other instances where a tenant uses land for non-agricultural purposes), but to not address it in the case of environmental land management schemes runs counter to other encouragements to diversify farming.
29. For cases where land is farmed by the landowner, we believe that consideration should be given to expanding the definition of Business Property Relief, so that any value of land used for environmental land management schemes in excess of the agricultural value is not exposed to Inheritance Tax.
30. Where Agricultural Property Relief and/or Business Property Relief is not available, clarity needs to be provided in respect of whether Woodlands Relief for Inheritance Tax would apply for woodland carbon credit cases. Similar principles/concerns to those noted in Part 1 would apply equally in this case.

Q2: Do you agree that the qualifying conditions for relief would need to be underpinned by live undertakings and ongoing adherence to those undertakings at the point of transfer?

31. ICAS is broadly supportive of this. As a professional body with members based across the UK, we feel that it is important that any similar schemes that operate in Scotland, Wales or Northern Ireland are given similar treatment to English schemes for the purposes of UK wide taxes. The importance of effective environmental land management applies equally throughout the UK.

Q3: Do you agree with the potential proposed approach to the list of Environmental Land Management Schemes that could qualify for relief where the activities covered relate to land being taken out of agricultural use?

32. This appears to be a reasonable approach.

Q4: Could the government remove the list of existing enactments for land habitat schemes in the existing legislation? Are you aware of any land continuing to qualify for relief now under any of the existing enactments?

33. In view of the limited number of land habitat schemes in place, we do not anticipate any significant disadvantages to this change. Our members have not made us aware of cases of any land continuing to qualify for relief under existing legislation that may be affected.

Q5: What agreements that meet high verifiable standards and have robust monitoring could be added to any list of qualifying Environmental Land Management Schemes? Please explain, including any potential unintended consequences or tax planning opportunities that might need to be considered and how they could be addressed.

34. As an accountancy body, we are not best placed to advise on additional agreements. We do however strongly encourage parity in treatment between similar arrangements throughout the different regions of the UK.

Q6: How could the government achieve its intention not to expand the scope of relief beyond agricultural land that was being used for agricultural purposes? What would the practical challenges be for those claiming relief and how could they best be overcome?

35. We recognise that the government may not wish individuals to qualify for Agricultural Property Relief in respect of land used for environmental land management, where the land would not otherwise qualify for relief. This could potentially be achieved by only extending the scope of the relief where the conditions for Agricultural Property Relief were complied with before the change of land use. This would seem to be an entirely reasonable approach.

Q7: How could the environmental land be valued most appropriately? What would the practical challenges be and how could they best be overcome?

36. Whilst we are not valuation specialists, our members report to us that the question of valuation for Inheritance Tax purposes can be extremely difficult in any case. They cite the need to obtain notional valuations of estates with a level of breakdown that can have very significant tax effect but is totally unrepresentative of the actuality of any situation. The inclusion of environmental land is unlikely to change this.

Q8: Are there any other design issues that would need to be considered if the government decides to update the land habitat provisions in agricultural property relief?

37. As noted elsewhere, consideration should be given to changing the interaction with Business Property Relief for Inheritance Tax, in cases where there is additional value above agricultural value.

Q9: What would the impact be of restricting 100 per cent agricultural property relief to tenancies of at least 8 or more years?

38. ICAS believes that extending the minimum requirement will result in more farms being farmed by the landowner themselves or using contract farming arrangements. Where leases still exist, it is possible that landowners will wish to enter into longer-term lease agreements to ensure availability of Agricultural Property Relief. But our feedback in this regard is purely anecdotal.
39. In either case, as the occupier of the land will have a longer-term interest, there will be greater incentive for them to invest in the land and take part in environmentally friendly initiatives for the longer term. Indeed, the attractiveness of environmental land management schemes may be increased because of the long-term commitment.

Q10: What exclusions would be necessary and how could these be defined in legislation if the government pursued this approach?

40. Whilst we are not qualified to comment on the legal position, the government will need to consider the legal practicalities from the Scottish legal system in terms of leases and how the changes between the different legal systems could create conflict.

Summary

41. Overall, ICAS is supportive of measures which help the UK achieve net zero and ensure more effective land management. We are also mindful of the Scottish Government's sustainability goals.
42. Putting the availability of Inheritance Tax reliefs beyond doubt should ensure that farming businesses are not deterred from exploring environmental land management schemes and ecosystem service markets. Clarity on the treatment of income within trading profits would be useful and we recommend that the Capital Gains Tax legislation is updated to ensure that there is consistency across the taxes.
43. Without resisting the proposals to extend the qualifying period for Agricultural Property Relief for tenanted land, we recommend that the government fully considers the Scottish legal position to ensure that there is not a tax disadvantage for land being let in Scotland.



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